SEP 8 1939
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Supreme Court of the United States.

OCTOBER TERM, 1939.

No. 246.

FREDERICK S. DEITRICK,
RECEIVER OF THE BOSTON-CONTINENTAL NATIONAL BANK,
Petitioner,
v.
THOMAS E. GREANEY,
Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

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recover from the defendant Greaney and another the amount of a promissory note signed by the defendant Greaney.

The defendant Greaney, in his answer (R. 7-10), admitted the execution of the notes and transfers of stock described in the plaintiff's bill, but denied that he or Karnow ever became the owners of said stock, and alleged that said transactions were effected at the request of the bank and for its accommodation, that the bank at all times owned the stock, that it was never intended that any of the defendants should become the owners of said stock, and that the successive transfers to Greaney, Karnow and Mahoney were made to secure the maker of the accommodation note or notes held by the bank.

At the trial of the case in the District Court the following facts were found:

Early in 1930 the Boston National Bank, in violation of the National Banking Act, became the owner of 190 shares of its own capital stock. In order to conceal this fact, the bank, acting through one Ulin, its president, induced the defendant Karnow to execute and deliver to the bank for its accommodation his note in the sum of $23,500. Karnow's note was discounted, the proceeds turned over by Karnow to the defendant Greaney, who at that time was a director of the bank, and Greaney in turn paid the money over to the bank. The shares of stock were thereupon transferred upon the books of the bank to Greaney (R. 13, 14).

From time to time Karnow was induced to renew the note given by him to the bank, and shortly after the first renewal he had the stock standing in Greaney's name transferred on the bank's records from Greaney's name to his own and took actual possession of the certificates (R. 14).

In December of 1930 the Boston National Bank was consolidated with the Continental National Bank under the

name Boston-Continental National Bank, and the 190 shares of Boston National Bank stock standing in the name of Karnow became convertible into 684 shares of stock of the consolidated bank, with a par value of twenty dollars ($20) per share, and were so converted. Prior to the consolidation and conversion of the stock, the Boston National Bank had agreed to sell the 190 shares of its own stock to two officers of the Continental National Bank, named Ragan and Balter, at one hundred fifty dollars ($150) a share, and took a series of notes from the purchasers in payment. Three of the notes, totalling twenty-four thousand dollars ($24,000), were delivered to Greaney with instructions to obtain from Karnow shares of stock as paid for by the payment of said notes (R. 14).

In March of 1931 the first Ragan and Balter note, in the amount of nine thousand five hundred dollars ($9500), was paid. Pursuant to the aforesaid instructions, Karnow released 222.8 shares of stock of the consolidated bank for delivery and transfer to the purchasers, and Karnow was credited on the bank's books with the payment of nine thousand five hundred dollars ($9500) on account of his note (R. 14, 15).

In the early part of May, 1931, at the insistence of Karnow, the consolidated bank agreed to deliver up Karnow's note, at the same time inducing the defendant Greaney to substitute his note to the bank in the sum of fourteen thousand five hundred fifty-three dollars and sixty-six cents ($14,553.66), which at that time represented the then unpaid balance of the Karnow note appearing on the bank's books. At or about the same time the stock held by Karnow was surrendered and put in the name of the defendant Mahoney without his knowledge or consent (R. 15).

In December of 1931 the consolidated bank was closed and a receiver appointed, and on July 11, 1932, an assessment was made by the Comptroller against all stockholders

of said bank equal to the par value of their stock, but the assessment upon the 457.2 shares standing in the name of Mahoney was never paid (R. 15).

On June 16, 1938, the court filed an opinion (R. 13-17) wherein certain findings of fact and rulings were made pursuant to which a final decree was entered on June 30, 1938 (R. 12), dismissing the bill as against the defendants Karnow and Mahoney, adjudging the defendant Greaney liable upon a stock assessment in the amount of $9144 with interest as the owner of 457.2 shares of stock standing in the name of the defendant Mahoney, and adjudging him liable to the plaintiff in the sum of $14,553.66, the amount of the promissory note held by the bank, together with interest.

Thereafter, on September 28, 1938, the defendant Greaney appealed to the Circuit Court of Appeals for the First Circuit from the final decree entered on June 30, 1938 (R. 17).

After argument and hearing, the Circuit Court of Appeals on March 25, 1939, rendered an opinion (R. 77-90), and on the same day entered a decree (R. 90) in which it reversed the decree of the District Court in so far as it held the defendant Greaney liable on his note for fourteen thousand five hundred fifty-three dollars and sixty-six cents ($14,553.66), ordered the suit dismissed as to such liability, and affirmed the decree of the District Court in so far as it established the defendant Greaney's liability in the amount of nine thousand one hundred forty-four dollars ($9144), together with interest, as an assessment on 457.2 shares of stock of the Boston-Continental National Bank (R. 90-91).

Thereafter the plaintiff, seeking a review of the decree of the Circuit Court of Appeals, filed a petition for a writ of certiorari with this Honorable Court. The defendant Greaney filed a cross-petition for a writ of certiorari, being docket No. 247, seeking a review of that part of the decree of the Circuit Court of Appeals which adjudged him liable for a stock assessment.

Summary of Argument.

It is submitted that the evidence and the express findings of fact of the District Court disclose that the giving of the note and the bank's apparent relinquishment of the stock constituted only a colorable transaction, and were merely part of a scheme to conceal from the bank examiner the bank's illegal ownership of the stock. The undisputed testimony at the trial of the cause and the findings of the District Court establish that the bank never actually parted with its beneficial ownership of the shares of stock, and that none of the parties intended that the promissory note be considered an actual obligation.

It is respectfully submitted that the portion of the opinion of the Circuit Court of Appeals (R. 77-84) which exempts Greaney from liability on his promissory note is in complete accord with the principles set forth in established decisions to the effect that the receiver of a closed national bank may not recover from the maker of an accommodation note given to the bank at its request and taken by the bank for the purpose of concealing the ownership of shares of its own stock previously acquired by it in violation of law.

In the plaintiff's attempt to hold Greaney liable on his note, great weight is placed upon the fact that Greaney was a director in the bank of which the plaintiff is the receiver. Such argument by the plaintiff might be sound if this were a suit by a receiver of a closed national bank on behalf of its creditors to impose liability on a director for a breach of duty to depositors, but the pleadings do not state such a case. This is merely a suit by a receiver to recover on a note as an asset of the bank. In such a proceeding the fact that the maker of the note was also a director of the payee cannot deprive the maker of his agreement with the payee that the note would not be enforced

against him. Particular attention should be directed to the fact that the bill in equity does not allege, nor is there any evidence or finding, that the giving of the note in suit in any way damaged the bank or its depositors or deceived the bank examiner. The evidence and findings in the case clearly establish that the bank acquired the shares of stock in question considerably before the defendant gave the note in question. The bank gave up nothing and acquired nothing when it took the note in suit. The findings of the District Court clearly show that this note was taken, not to divest the bank of its ownership of the stock, but to conceal its continued ownership. *The giving of the note under such circumstances did not increase or decrease the assets of the bank.*

Despite the contentions of the petitioner, it is clear that the validity and enforcibility of the note in suit is to be governed by Federal court rules of decision and not by Massachusetts law. Furthermore, the decision of the Circuit Court of Appeals does not conflict with decisions of the Massachusetts courts.

Argument.

I.

THE RECEIVER OF A CLOSED NATIONAL BANK MAY NOT RECOVER FROM THE MAKER OF AN ACCOMMODATION NOTE GIVEN TO THE BANK, AT ITS REQUEST, AND TAKEN BY THE BANK FOR THE PURPOSE OF CONCEALING ITS OWNERSHIP OF SHARES OF ITS OWN STOCK PREVIOUSLY ACQUIRED BY IT IN VIOLATION OF LAW.

The Circuit Court of Appeals followed the well-established decisions of this Honorable Court and of Federal courts of inferior jurisdiction when it reversed that part of the decree of the District Court which adjudged the de-

fendant Greaney liable on his note. In this respect the District Court made the following basic finding:

> "Early in 1930, the Boston found itself in a position where it was the owner of 190 shares of its own stock. This ownership came about by the purchase of the stock from one of its directors who threatened to dump it on the open market. Fearing the result of such action, the bank took the stock over, and carried it as a cash item. Such ownership was in violation of the National Banking Act. 12 U.S.C.A. Sec. 83. In order to conceal this illegal ownership, a scheme was devised whereby the note of some third person would be carried on the bank's books as a receivable, and the stock would be carried on the records either in the name of that third person, or in someone's name other than the bank" (R. 13).

This finding clearly establishes that the acts of the parties in giving the promissory note and in registering the stock in the name of persons other than the bank were entirely fictitious and of no legal effect. The net result of these transactions was as if the shares of stock had never been transferred out of the bank's name.

All the cases bearing upon the liability of the maker of a promissory note given to a national bank for its accommodation, and to enable it to conceal from the bank examiner its true financial condition, establish the following propositions:

(1) The maker may set up lack of consideration as a defense;

(2) Participation by the maker in such an illegal transaction does not aid the bank's receiver, but precludes recovery by him;

(3) The receiver of the bank is in no better position than the bank itself would have been.

In *Rankin, Receiver*, v. *City National Bank*, 208 U.S. 541, this Honorable Court rendered a decision involving the principles under discussion in the case at bar. In that case the president of a bank arranged with the defendant bank (called the City Bank) to discount his individual note and deposit the proceeds to a special account in the name of his bank (called the Guthrie Bank) under an arrangement whereby these funds were not to be drawn against but were to remain with the City Bank until the note was paid. The purpose of this transaction was to effect a reduction of certain loans to which the examiner had objected as excessive. The president gave his bank a check on the City Bank, the amount of which was credited to his personal account, and on the same day he gave his bank a check on his personal account, which was credited to bills receivable, and the objectionable notes were taken out of the bank's assets. The receiver of the Guthrie Bank sued to recover the deposit to its credit which the City Bank had offset against the note held by it on the day that the Guthrie Bank closed. It was agreed by the parties that the transaction between the banks was not illegal, but in affirming a decision in favor of the defendant bank, the court enunciated certain well-defined principles in the following language:

> (P. 545) " * * * the whole business from beginning to end, was and was intended to be a mere juggle with books and paper to deceive the bank examiner. The City Bank never received anything from the Guthrie Bank, the Guthrie Bank never parted with anything to the City Bank, or with anything for the loss of which the City Bank is responsible, if it parted with anything at all."
>
> (P. 546) "As between the banks no one got any money, and the only benefit of the loan in fact or contemplation was a swindle upon the bank examiner * * *.

If the Guthrie Bank had sued while it was a going concern it could not have recovered, and the receiver stands no better than the bank * * *."

(P. 547) "In view of the statement of counsel, at the argument * * * that they did not contend that the contract was illegal * * * and in view of the possibility that the facts were found as they were with that agreement in view, we shall not consider that aspect of the case. *It would not help the plaintiff. McMullen* v. *Hoffman,* 174 U.S. 639." (Italics ours.)

The decision in the Rankin case has quite recently been approved and reaffirmed by this Honorable Court in *Deitrick, Receiver,* v. *Standard Surety & Casualty Co.,* 303 U.S. 471, in which case the issues were identical with those in the case at bar. Actions were brought by the receiver of a closed bank on surety bonds given to the bank to secure the payment of certain discounted notes and the surety company brought a bill in equity to cancel the bonds because of fraud. The surety company set up that the bonds had been obtained from its agent on the representation by the bank that it would not hold the surety company liable and merely wanted to be able to show the bond in case the examiner should ask for collateral.

Decisions in favor of the surety company in the District Court were affirmed by the Circuit Court of Appeals, which approved without reservation the same contentions advanced by the defendant herein, that the plaintiff as receiver is in no better position than the bank and indeed is precluded from recovery by its participation in the illegal transaction.

The Circuit Court in its opinion, found in 90 F. (2d) 862, said:

(P. 865) "It is clear from the pleadings that the receiver seeks to recover on these bonds as assets of the

bank. In such an action he stands no better than the bank itself. All defenses open against the bank in such a case are open against the receiver, and he is chargeable with knowledge of all the facts known to the bank affecting the character of the claim. While there are decisions in the state courts to the contrary, the federal courts sustain this position [citing many cases, including *Cutler* v. *Fry*, 240 F. 238; *Yates Center National Bank* v. *Schaede*, 240 F. 240; aff'd 240 F. 241; *Bank* v. *Lauber*, 240 F. 237; *Rankin* v. *City Nat. Bank*, 208 U.S. 541].

"If therefore the contract with the surety company was illegal as to the bank * * * a recovery could not be had by the receiver."

This Honorable Court in affirming the decision of the Circuit Court of Appeals discussed the Rankin case and with reference thereto said:

(P. 480) "We adhere to the doctrine there approved and regard it as decisive of the present cause."

In *Yates Center National Bank* v. *Lauber*, 240 F. 237, pursuant to an arrangement to help the officers conceal the financial condition of the bank, the bank turned over certain worthless notes to the defendant for his note, and agreed that it would at any time accept them in satisfaction of his note. The court refused to hold the defendant liable, saying:

(P. 238) "* * * the illegality of the entire matter so clearly appears as to prevent a court of justice from affording any relief based thereon."

In *Cutler* v. *Fry*, 240 F. 238, the defendant was induced to give his note in exchange for the president's note, to

help conceal defalcations of the president, under an agreement that the bank would at any time take the president's note in payment of the defendant's note. The court held that lack of consideration was a defense, and said:

> (P. 239) "However, the rights of the receiver of the bank to recover on the note in question rise no higher than the rights of the bank had insolvency not intervened * * * in the hands of the original payee or its receiver, as is this case, both the note and the contemporaneous agreement constituted the entire contract between the parties and, when the agreement thus formed is presented, the illegality of the whole matter so clearly appears the court will leave the parties where it finds them by refusing all relief. *Rankin* v. *City National Bank* 208 U.S. 541; *McMullen* v. *Hoffman* 174 U.S. 639."

In *Yates Center National Bank* v. *Schaede*, 240 F. 240 (affirmed without opinion by the Circuit Court of Appeals for the Eighth Circuit, 240 F. 241), the court refused to enforce a note given to a bank without consideration to conceal the defalcations of its president, saying:

> (P. 240) "Not only is this defense (want of consideration) made out but it further appears that the whole transaction from the making of the original note to the renewal in controversy, was without consideration and in pursuance of the illegal and criminal design of the president of the bank. Such state of facts public policy and good morals alike condemn, and courts refuse to enforce."

In *Andresen* v. *Kaercher*, 38 F. (2d) 462 (C.C.A. 8th), the bank had a claim against the estate of one Kaercher and entered into an agreement with the defendants whereby the

defendants deeded certain real estate to the bank (which was to be sold as soon as possible) and gave to the bank accommodation notes so that the bank might be able to show them as assets until the real estate should be sold. The trial court directed a verdict for the defendants, and this decision was affirmed on appeal, the court stating:

> (P. 464) "The receiver of an insolvent bank stands in no better position than the bank stood as a going concern. *Rankin* v. *City National Bank* 208 U.S. 541, *Petersen* v. *Tillinghast* 192 F. 287. • • • it cannot be contended that the Citizens National Bank while a going concern could have maintained actions against them to recover on the notes. *Cherry* v. *City National Bank* 144 F. 589, 591."

The court answered the argument that the defendants had been guilty of a concerted attempt to deceive the Comptroller of the Currency, in the following language:

> (P. 464) "But, be this as it may, the result is not affected because the court will not lend its assistance in any way towards carrying out an illegal contract, nor will it enforce any alleged rights directly springing from such a contract. *McMullen* v. *Hoffman*, 174 U.S. 639. In this view the bank itself could not have collected, nor is the receiver more advantageously situated • • •."

The foregoing authorities, it is submitted, establish that, where a note is given to a bank for its accommodation and to conceal its true financial condition from the Comptroller's office, the maker may set up the defense of lack of consideration as against the bank's receiver, and that, even at the instance of the receiver, the courts will not enforce a note given as part of such an illegal transaction. The bank's

unge into insolvency and receivership does not absolve of the taint of illegality, which persists to bar recovery by e receiver. His rights are in no way superior to the ghts of the bank, and, that being so, the time-honored rinciple denying enforcement of illegal obligations must tain.

II.

IN A SUIT ON AN ACCOMMODATION NOTE GIVEN TO A NATIONAL NK, AT ITS REQUEST, AND TAKEN BY THE BANK FOR THE PURPOSE CONCEALING ITS OWNERSHIP OF SHARES OF ITS OWN STOCK EVIOUSLY ACQUIRED BY IT IN VIOLATION OF LAW, LIABILITY OF IE MAKER CANNOT BE PREDICATED MERELY ON THE FACT THAT E WAS A DIRECTOR OF THE BANK.

As shown above, it is clear that the note transactions in estion were fictitious, without consideration, and constituted an illegal agreement, so that no recovery on the tes can be had by the bank or its receiver. The fact that e maker of the note in suit was a director of the bank nnot alter the situation. To be sure, he owes duties to e bank which another might not owe, but he is not being ed for dereliction of duty—he is being sued as the maker a note, and there is no principle or authority which would pply consideration when none existed, which would exculte the bank *in pari delicto* or which would give to the reiver rights superior to those enjoyed by the bank, merely cause he was a director.

Furthermore, the receiver here is suing to recover on the te as an asset of the bank. In such a suit the receiver nnot recover on account of any rights derived through editors of the bank and arising out of damage to them. he pleadings do not allege deception of or any damage creditors and depositors, nor, in fact, is there any allegaon that the bank examiner was deceived. Precisely the

same question was in issue in the case of *Deitrick, Receiver, v. Standard Surety & Casualty Co.*, discussed in detail above, where the court said:

> (P. 480) "An examination of the pleadings makes it quite clear that the Receiver undertook to set up rights acquired by the insolvent bank through duly executed contracts between it and the Surety Company. He makes no suggestion of a purpose attributable to the company to mislead creditors or others; makes no allegations of damage except that sustained by the bank. He sets up no facts which would render unconscionable a denial of liability upon the bond because of the agent's fraud, obviously induced by the president of the bank. In this state of the pleadings the Receiver may not have judgment; he cannot rely on something not complained of, nor can he have damages because of supposed deceptions which the pleadings fail to suggest."

It is submitted that the decision of the Circuit Court of Appeals denying recovery on the note was in complete accord with the well-established decisions of this Honorable Court, and that the District Court, in addition to departing from the decisions of this Honorable Court, erred in enforcing a right not asserted and not litigated.

III.

THE PETITIONER SHOWS NO CAUSE FOR THE GRANTING OF HIS APPLICATION FOR A WRIT OF CERTIORARI.

The petitioner urges that a writ of certiorari should issue because the decision of the Circuit Court of Appeals was contrary to applicable decisions of the Massachusetts Supreme Judicial Court and contrary to principles established by this Honorable Court. It has been shown above that the decision of the Circuit Court of Appeals with respect to

Greaney's liability on his note was in complete accord with well-established decisions of this Honorable Court. The respondent submits that there is no conflict with decisions of the Massachusetts courts and that the decisions of the Massachusetts courts are not applicable to the issue in this case.

The Massachusetts decisions on which the petitioner relies do not involve suits by or in behalf of *national* banks. Both of the Massachusetts cases cited by the petitioner are easily distinguishable from the case at bar, since in those cases the defendant in each instance gave his obligation to the bank in actual substitution for a real asset held by the bank, thereby affording a consideration. In the case at bar, Karnow in the first instance gave his note to the bank, not in substitution for an asset of the bank, but to aid the bank in concealing its continued illegal ownership of its own shares of stock. Under such circumstances, Karnow could not be held liable to the bank or its receiver, even under the Massachusetts decisions on which the plaintiff relies, since Karnow was not an officer or director of the bank. The evidence and findings (R. 14, 15) clearly establish that Greaney gave the note in suit in substitution for Karnow's note, and that there was an "agreement between the bank and Greaney to the effect that he was to stand in Karnow's shoes" (R. 15). Under such circumstances, it is clear that there was no consideration for Greaney's note—the bank gave up nothing except the illegal, unenforcible Karnow note,—certainly not an asset of the bank—and agreed that the Greaney note should be held on the same terms. There was no damage to the bank or its depositors, such as induced the Massachusetts court to impose liability in the cases relied upon by the plaintiff. Furthermore, neither of those decisions involves the enforcibility of an illegal agreement where both parties are *in pari delicto*. The Massachusetts decision principally relied upon by the petitioner

discusses only the question of consideration and fraudulent inducement, although it is true that with reference to the latter question the court uses loosely the word "invalidity." There could have been no question of illegality of the transactions involved in the Massachusetts decisions since the Massachusetts statutes regulating banks, unlike the Federal statutes, contain no provisions imposing a penalty on transactions intended to deceive a bank examiner. For that reason illegality was not pleaded as a defense in the Massachusetts cases and they do not serve as authority upon which the Federal court might rely.

In any event it is submitted that decisions of the Massachusetts courts do not govern the validity of the note in question. The petitioner relies on the case of *Erie Railroad Co.* v. *Tompkins*, 304 U.S. 64, to support his contention that Massachusetts law governs this question. In that case the court says:

> (P. 78) "Except in matters governed by the Federal Constitution or by Acts of Congress, the law to be applied in any case is the law of the state."

It is submitted that the case at bar comes within the foregoing exception as a case arising under the Acts of Congress. An action by or against a receiver of a national bank, appointed under the Banking Act, is an action arising under the laws of the United States because an Act of Congress creates his office, grants his rights and powers and imposes his duties. In the absence of this Act there would be no such receiver and no suits by or against him could arise. Every action by or against him necessarily involves the exercise of some of his rights, or the proper discharge of some of his duties, and invokes a consideration of the proper construction and effect of the laws of the United States from which he derives them. *Auten* v. *U.S. National Bank*, 174 U.S. 125.

The basic question in the case at bar is whether or not the note in suit is such an asset of a national bank as will entitle its receiver to maintain a suit thereon. Certainly such a question should be uniformly decided so that the right of a national bank or its receiver to enforce such a note should not vary according to the law of each State. This Honorable Court would not countenance such a probable lack of uniformity in the determination of the liability of a shareholder in a national bank for an assessment. The dangers of allowing such matters to be subject to the rules established by different State courts can be further illustrated in the problems of set-off which arise continually in the liquidation of insolvent national banks—certainly Federal courts should not be expected to follow a State court if it should decide that a debtor of an insolvent bank might obtain the benefits of a set-off by acquiring the claim of a depositor after the closing of a bank.

The decision in *Deitrick, Receiver,* v. *Standard Surety & Casualty Co.* (*supra*) may be used as authority for the proposition that the validity and enforcibility of an obligation deemed to be an asset of a closed national bank is not governed by State law but comes within the above-quoted exception to the general rule established by *Erie Railroad Co.* v. *Tompkins* (*supra*). The Tompkins case was argued on January 31, 1938, and decided on April 25, 1938. The Deitrick case was argued on March 7 and 8, 1938, and decided on March 28, 1938, at a time when this Court had the Tompkins case under consideration. After the decision in the Tompkins case, this Honorable Court, on May 2, 1938, denied a petition for a rehearing of the Deitrick case. It should be noted that the decision in the Deitrick case follows and reaffirms the rule of law established in the Rankin case discussed at length above, and that neither case purports to follow the rules of decision of any but the Federal courts.

The validity of the note in question arises under the Acts of Congress, since it was given to conceal the continued ownership by the bank of its own shares of stock held in violation of section 5201 of Rev. Stat. of 1873 (U.S.C. Title 12, sec. 83). On page 12 of the plaintiff's petition for a writ of certiorari the following argument is found: "As indicated herein above, the question presented by this case is one of great importance with respect to the stability and proper management of the institutions which make up our public banking system." Such a contention on the part of the petitioner, joined in by the Comptroller of the Currency, although not a reason for holding such a note enforcible, clearly exhibits that the question in issue is one that should be uniformly decided by the Federal courts and not subject to the vagaries of State court decisions.

Conclusion.

The decree of the Circuit Court of Appeals denying the right to enforce the note in suit was in complete accord with the decisions of this Honorable Court. Massachusetts law does not govern the question in issue and the decision of the Circuit Court of Appeals is not in conflict with any decisions of the Massachusetts courts. Accordingly the petitioner has shown no grounds for the granting of his application for a writ of certiorari.

Wherefore your respondent respectfully submits that the plaintiff's application for a writ of certiorari should be denied.

THOMAS E. GREANEY, *Respondent,*
By his Attorney,
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